SENATE FINANCE & CLAIMS

Exhibit No. 1

Date 2-22-07

Bill No. SB543

<u>SB543 – Revise Fiscal Notes</u> (Sen. Joe Balyeat)

This is a pretty simple bill. It simply adds two requirements to the rules regarding fiscal notes:

1) Fiscal notes must reflect the changes in behavior resulting from policy changes in the bill; and an estimated fiscal impact of those behavior changes. This is what the literature would call a "dynamic" fiscal model, as opposed to our current "static" fiscal model.

Currently, if you have a bill changing tax rates, The Budget office and DOR just calculate the current number of taxpayers, at current economy levels, times the tax rate change – and that's your fiscal note. There is no consideration given to the fact that changing tax rates, leads to changed economic behavior in the private sector.

But we all know that that's not how the world works. We may debate how much tax increases and decreases effect behavior; but I think we can all agree that such changes certainly <u>do</u> affect behavior; and academic study after academic study confirms that view.

Why should we change to a dynamic model? Why should we pass this bill? Certainly there's the political consideration. I submit that both political conservatives and liberals should like this bill. Take a tax cut bill for example. Conservatives would like the dynamic fiscal note because it would result in a lower cost for the tax cut – lowering rates will result in greater activity which offsets some or all of the cost of the tax cut. Liberals would like the tax cut's dynamic fiscal note because it would show a lower "hit" on the budget; leaving more money to spend on programs.

But aside from the politics, there's the policy considerations: certainly it's in the best interest of Montanans that we consider legislation in light of the most accurate financial data we can get. It's simply financial foolishness to budget billions of taxpayer dollars based on inaccurate fiscal notes. And common sense as well as academic literature will tell you – changes in law result in changes in private sector behavior. Any financial analysis which ignores those behavior changes is simply incomplete and, therefore, inaccurate.

Is this do-able? I submit that the budget office already does this, whenever it's convenient, or they want to do. Here's a simple example – if a new tax credit is proposed, the fiscal note says, "It's estimated that 150 taxpayers will take advantage of this new credit." They're predicting a change in behavior resulting from a change in tax policy.

Moreover, even when it's not convenient, they utilize a dynamic model when the bill sponsor has favor. Example – last session, we had the State Auditor's bill to cap premium taxes on Captive Insurance Companies. Here's a direct quote from the fiscal note assumptions: "This cap will make Montana competitive with other Captive Insurance [state] domiciles that already have caps on premium taxes in place. As Montana attracts more Captive Insurance companies, the amount of premium taxes collected will increase." During the hearing, both Auditor Morrison and bill sponsor Mike Wheat agreed openly with the premise that lowering this tax rate makes MT more competitive, attracts more business to Montana; and, thus, leads to increased tax collections.

I might add that we passed the bill based entirely on that "dynamic" premise; and, two, years later we have proof that the prediction was accurate… so much so that Auditor Morrison is now back with another bill attempting to iron out the kinks in Captive Insurance Regulation to attract even more Captives to MT.

2) SB 543 proposes that fiscal notes must include an estimate of costs to the private sector that will occur as a result of the policy changes in the bill. I again argue that we aren't getting the whole picture with fiscal notes that merely reflect the costs to government; without also estimating the costs of new legislation to the private sector.

Just yesterday, in Senate Business & Labor, we passed Chairman Cocchiarella's SB466 – a paired down version of the Small Business Regulatory Flexibility Act. SB466 is a small amendment to the existing statute, This statute already says 15 legislators can request an analysis quantifying the 'probable economic impact of proposed rule changes upon affected classes of persons and affected small businesses.'

Now, if 15 legislators can request that impact analysis resulting from mere proposed rule changes, surely 50 Senators can request the same analysis be done for proposed statutory changes. And that's exactly what this bill asks for.

I suppose there might be opposition from the budget office saying these things aren't do-able; or will cost too much. It's the tendency of bureaucracies to avoid change. And the typical approach is to grossly overestimate the cost and consequence of bureaucratic changes. But members of the committee, I urge you to resist those exaggerations. Computer technology has advanced to the point where these things are easily do-able; and I've provided you examples where both of the changes proposed in this bill are being done already on occasion. But, as we represent the good people of the State of Montana, with the billions of dollars they've entrusted to our care, shouldn't we have consistency rather than merely occasional accuracy; consistently requiring the most accurate fiscal notes possible for each piece of legislation we consider.

Madam Chair, given the time crunch we're under these days, I deliberately didn't seek out any proponents for this bill. There may be some, but if not I'm hopeful that the committee will consider the bill on its own merits. So I'll sit and listen to proponents and opponents, if any, and reserve the right to answer questions and close.